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DOUBLE-CLICK¹ ON THIS: KEEPING PACE WITH ON-LINE MARKET MANIPULATION

*The goal is simply to prohibit every . . . device used to persuade the public that activity in a security is the reflection of a genuine demand instead of a mirage.*²

I. INTRODUCTION

First there was the telegraph.³ Next came the stock ticker,⁴ the telephone,⁵ and later the television.⁶ With each invention the speed

1. To “click” means to depress and release the mouse button on a computer. See WEBSTER’S UNIVERSAL COLLEGE DICTIONARY 149 (1997). To “double-click” means to click the mouse button twice in rapid succession. Explosive growth in the number of computer users has spawned the development of numerous new terms which are now part of our common vernacular. For example, a user selects an item by “clicking” on it and chooses an item by “double-clicking” on it.

2. S. REP. NO. 73-1455, at 54 (1934). In 1941, it was noted that the main antimanipulation provision of the Securities Exchange Act of 1934 (“Exchange Act”), section 9(a)(2), was the “very heart of the Act.” HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 77TH CONG., REPORT OF THE SEC ON PROPOSALS FOR AMENDMENTS TO THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934 50 (COMM. Print 1941) [hereinafter SEC REPORT ON PROPOSALS FOR AMENDMENTS].

3. The modern telegraph resulted from the development of the electromagnet in the 1830s. See 11 THE NEW ENCYCLOPAEDIA BRITANNICA 611 (15th ed. 1988). The electromagnet “provided Samuel Morse with a way to transmit and receive electric signals.” *Id.* Morse developed the operator key which, when depressed, “completed an electric circuit and sent a signal to a distant receiver.” *Id.* Around 1856, a sounding key was developed which enabled skilled operators to listen to what the key “said” and transcribe it. See *id.* In 1866, a transatlantic telegraph cable was completed, allowing communication between traders in New York and London. See Suzanne McGee, *Stock Markets May Look Nothing Like They Used To; But They Still Serve the Same Crucial Role*, ASIAN WALL ST. J., Jan. 18, 1999, at S11.

4. “[T]he stock ticker was developed at the New York Stock Exchange [“NYSE”] in 1867.” 11 THE NEW ENCYCLOPAEDIA BRITANNICA, at 759. The high-speed teletype would print the stock symbol, number of shares, and price of a transaction; this information was then transmitted to tickers at brokerage firms. See *id.*

5. The telephone is an electrical device invented by Alexander Graham

with which information could reach the securities markets increased, investor access to informational resources and market research improved, and transaction costs decreased.⁷ Then there was the Internet.⁸ The emergence of the Internet is revolutionizing societal methods of communication.⁹ As the court in the seminal Internet law case of *ACLU v. Reno*¹⁰ noted, the Internet is a "unique and wholly new medium of worldwide human communication."¹¹ Never before has a technology caught on so fast.¹² Currently, World Wide Web¹³ users

Bell, who patented the technology in March, 1876. *See id.* at 615. By 1887, over 150,000 telephones had been installed in the United States. *See id.*

6. In 1926, Englishman John L. Baird was the first person to demonstrate a "true television system by electrically transmitting moving pictures." *Id.* at 617. Today, television plays a significant role in creating the climate in which stocks are bought and sold: "[T]elevision appearances by any of a variety of market players can hit the market just as hard as a warning from [Federal Reserve Chairman Alan] Greenspan." E.S. Browning, *Market Surge Is Being Powered by New Forces, Investors' Growing Use of Technology Changing the Rules*, ARIZ. REPUBLIC, Mar. 17, 1999, at E2.

7. *See* John C. Coffee, Jr., *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 BUS. LAW. 1195, 1195-96 (1997).

8. The Internet is "a giant network which interconnects innumerable smaller groups of linked computer networks." *ACLU v. Reno*, 929 F. Supp. 824, 830 (E.D. Pa. 1996), *aff'd*, 117 S. Ct. 2329 (1997) (describing in detail the creation, development, operation and private regulation of the Internet). Typically, a user employs one of two common methods to gain physical access to the Internet: first, a person may use a computer that is "directly (and usually permanently) connected to a computer network that is itself directly or indirectly connected to the Internet;" second, a person may use "a 'personal computer' with a 'modem' to connect over a telephone line to a larger computer or computer network that is itself directly or indirectly connected to the Internet." *Id.* at 832. *See generally* MARGARET LEVINE YOUNG ET AL., INTERNET: THE COMPLETE REFERENCE, MILLENNIUM EDITION 4-18 (1999) (defining the basics of Internet access).

9. *See generally* *A Framework for Global Electronic Commerce* (visited Apr. 8, 1999) <<http://whitehouse.gov/WH/new/commerce/index.html>>.

10. 929 F. Supp. 824 (E.D. Pa. 1996).

11. *Id.* at 844.

12. *See* Robert D. Hof, *The "Click Here" Economy*, BUS. WK., June 22, 1998, at 122.

13. The World Wide Web ("Web") is the most popular and advanced of three methods used to locate and retrieve information on the Internet--the other two being file transfer protocol and a program and format referred to as "gopher". *See ACLU*, 929 F. Supp. at 835-36. The Web uses a formatting language called hypertext markup language ("HTML") and allows Web browsers to display HTML documents containing text, images, sound, animation and moving video. *See id.* at 836. Essentially, the Web is a series of documents

number an estimated 70 million.¹⁴ "It took radio more than 30 years to reach 60 million people, and television 15 years."¹⁵ Worldwide, the Internet ties together an estimated 159 million users.¹⁶

Businesses are at the forefront of this revolution.¹⁷ At an alarming rate,¹⁸ actual or potential issuers¹⁹ and private individuals are constructing Web sites²⁰ to promote and sell a product, render a

stored in different computers all over the Internet. *See id.* The Web was created to "serve as the platform for a global, online store of knowledge, containing information from a diversity of resources and accessible to Internet users around the world." *Id.* *See generally* YOUNG, *supra* note 8, at 390-97 (discussing the various components of the Web).

14. *See Network Solutions* (visited Apr. 4, 1999) <<http://www.netsol.com/nsi/facts/html>> [hereinafter *Network Solutions*].

15. Hof, *supra* note 12.

16. *See NUA Internet Surveys* (visited Apr. 9, 1999) <<http://www.nua.ie/surveys/index.cgi>>. This figure includes Web users and users who use other methods of communication or remote information retrieval on the Internet. For example, users may also communicate through e-mail, listservs, USENET newsgroups, real-time communication, file transfer protocol, or gopher. *See ACLU*, 929 F. Supp. at 834-35.

17. *See* Hof, *supra* note 12.

18. Network Solutions, the registrar for all domain names with the .com, .org and .net top-level domains, had registered 3.4 million sites as of December, 1998. *See Network Solutions*, *supra* note 14. In the first quarter of 1998, 340,000 new sites were registered. *See id.* In the second and third quarters, the numbers rose to 443,000 and 507,000 new registrations, respectively. *See id.* In the fourth quarter of 1998, Network Solutions registered 621,000 new sites; astoundingly, 1.9 million of the total 3.4 million sites were registered in 1998. *See id.* Network Solutions had a government-approved monopoly in registering Internet addresses since 1993; however, the government recently signed an agreement with Internet Corporation for Assigned Names and Numbers, known commonly as ICANN, to spur private competition in the industry. *See* John Gibeaut, *Staking an Internet Claim*, A.B.A. J., July 1999, at 82. Consequently, five new companies entered the address registration business in May 1999, and another twenty-nine companies are anticipated by late June 1999. *See id.*

19. Generally, the term issuer refers to "every person who issues or proposes to issue any security." 15 U.S.C. §§ 77b(4), 78c(a)(8) (1994).

20. "A Web site is a collection of Web pages belonging to a particular person or organization." YOUNG, *supra* note 8, at 394. "A Web page is an HTML document that is stored on a Web server and that has a [Uniform Resource Locator, or URL] so that it can be accessed via the Web." *Id.* "Typically, the URLs of these pages share a common prefix, which is the address of the home page of the site. The home page is the 'front door' of the site, and is set up to help viewers find whatever is of interest to them on that site." *Id.* (emphasis omitted).

service, or disseminate information. Increasingly, the product peddled is a security.²¹ The number of Web users is expected to increase to 477 million by 2002, "with [W]eb pages growing seven-fold to 7.7 billion during the same period."²² The Internet promises to make the securities markets more efficient and effective. Approximately three million people now have on-line trading accounts, a statistic that by 2001 is expected to reach fourteen million.²³ In even larger numbers, investors routinely use the Internet's financial forums to seek prospective investments and discuss actual ones.²⁴ According to recent headlines, it seems like fraud and market manipulation are having no problem keeping pace.

The Internet has numerous applications, especially for the small investor, which distinguish it from earlier forms of technological innovation.²⁵ The Internet provides not only a useful source of

21. Generally, "[t]he term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest, or participation in any profit-sharing agreement" 15 U.S.C. §§ 77b(1), 78c(a)(10) (1994). In 1998, an estimated 22 percent of all securities transactions were conducted on-line compared to virtually no such transactions in 1995. See United States General Accounting Office, *Securities Fraud: The Internet Poses Challenges to Regulators and Investors: Testimony Before the Permanent Subcomm. On Investigations, Comm. On Governmental Affairs, 105th Cong. at 1* (Mar. 23, 1999) (statement of Richard J. Hillman, Associate Director, Financial Institutions and Markets Issues, General Government Division) [hereinafter *GAO Testimony*].

22. *Network Solutions*, *supra* note 14 (citing Internal Data Corporation statistics).

23. See Michael Schroeder, *Growth in Internet Securities Fraud Will Be Difficult to Combat*, *GAO Says*, WALL ST. J., Mar. 22, 1999, at C15; Aaron Lucchetti & Larry Bauman, *Small Brokerage Firms Surge on Internet Fever*, WALL ST. J., Feb. 5, 1999, at C7.

24. For example, as of February 24, 1999, over eight million "members" had posted messages to the Silicon Investor's Web site. See *Silicon Investor* (visited Feb. 24, 1999) <<http://www.techstocks.com/index.html>>. In its mission statement, the self-proclaimed "world's largest financial discussion site" insists that "[f]inancial information is no longer an exclusive privilege of Wall Street and its contingent of analysts and brokers. [Silicon Investor] seeks to bring a new financial order to Wall Street . . . one that benefits individual investors." *Id.* See also *Motley Fool* (visited Feb. 17, 1999) <<http://www.fool.com>>; *StockSelector.com* (visited Feb. 10, 1999) <<http://www.stockselector.com>>.

25. See generally Coffee, *supra* note 7 (arguing that the Internet implicates investor empowerment, market efficiency, statutory obsolescence, disinterme-

information for most market participants, but an important one.²⁶ The new medium essentially provides individual investors with the informational resources traditionally available only to market professionals. The posting of information pertaining to particular securities on the Internet affects, rather substantially, the way many investors make financial decisions.²⁷ A stock's price can be influenced within minutes of posting information on a newsgroup, a portal's message board, or, most commonly, on a Web site's message board²⁸ or discussion forum.²⁹

Unfortunately, along with such technological advances comes an increased opportunity to manipulate a stock's price over the Internet. Such manipulation injures the legitimate investor and undermines the integrity of the securities markets. One form of legal violation that can result from such a practice is "market manipulation," an action related to fraud, "but not altogether part of it as a matter of legal analysis."³⁰

This Comment addresses the application of the antimanipulation and antifraud provisions of the federal securities laws to manipulations that occur through the use of the Internet. Part II briefly explains the structure of the securities markets. Part III describes a classic market manipulation technique—the conventional boiler room. This part also sets forth the current statutory framework in place to combat market manipulation of both registered securities³¹

diation and fraud, among other things).

26. According to a February, 1998, survey conducted for MSNBC by Market Facts, Inc., 53% of domestic Internet users go online for news. *See Internetnews.com* (visited Feb. 17, 1999) <<http://www.internetnews.com/business/article/0,1087,3-19491,00.html>>. Research also revealed that the Internet is the preferred medium for accessing financial news, suggesting more at-work usage for financial news than any other topic. *See id.*

27. *See infra* Part IV.

28. A message board is "a portal's private newsgroup universe. It is organized into topic categories, and within a board the members start new topics . . . which can then be replied to by other members." YOUNG, *supra* note 8, at 562.

29. *See* Joseph J. Cella III & John Reed Stark, *SEC Enforcement and the Internet: Meeting the Challenge of the Next Millennium: A Program for the Eagle and the Internet*, 52 BUS. LAW. 815, 825 (1997). *See infra* Part IV.

30. LOUIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* 929 (3d ed. 1995 & 1999 Supp.).

31. Generally, to be legally offered or sold, a security must be registered pursuant to section 5 of the Securities Act of 1933 ("Securities Act"), unless

and the over-the-counter ("OTC") market.³² Part IV discusses emerging forms of on-line market manipulation and explores the particular susceptibility of thinly capitalized companies. Moreover, this part provides an overview of the Securities and Exchange Commission's ("SEC")³³ present approach to fighting on-line manipulation—applying established law to a revolutionary medium.

Finally, Part V concludes that, in order to curb the burgeoning problem of market manipulation on the Internet, the SEC must bolster its surveillance, policing, and enforcement efforts which, at present, are struggling to keep pace with the Internet's amazing growth rate. SEC and other regulatory programs aimed at combatting on-line fraud and manipulation are still young and face substantial challenges that may limit their success. Specifically, the programs have limited investigative staff resources which retard their ability to promptly and effectively respond to credible fraud tips. Furthermore, the numerous organizations charged with regulating the securities markets must develop a coherent and coordinated approach to battling on-line fraud and better educate the investing public about the risks of investing on-line.

II. A BRIEF OVERVIEW OF THE SECURITIES MARKETS

At this point it is useful to discuss briefly the structure of the securities markets. Where an issuer's stock is listed dictates the level of information about a company that must be publicly disclosed before its shares may be offered to the public. Basically, convention dictates drawing a distinction between the stock exchanges and the OTC market. Currently, eight stock exchanges are registered with the SEC.³⁴ Each exchange has its own requirements for listing, but

the security or transaction qualifies for an exemption. See 15 U.S.C. §§ 77c(a),(d) (1994).

32. See *infra* Part III.B.2.

33. Section 4(a) of the Securities Exchange Act of 1934 ("Exchange Act") created the SEC, an independent federal agency composed of "five commissioners to be appointed by the President by and with the advice and consent of the Senate." See LOSS & SELIGMAN, *supra* note 30, at 50. The SEC has four operating divisions: Corporate Finance, Enforcement, Investment Management, and Market Regulation. See *id.* at 51.

34. Of the eight exchanges, the NYSE has the highest average daily dollar volume—\$22 billion. See *id.* at 606.

all eight generally have similar listing policies.³⁵ Ultimately however, the main characteristic of an exchange is the centralization of trading on an exchange floor.³⁶

In contrast, OTC trading is not centralized at a particular physical location.³⁷ If a stock is not traded on an exchange, it trades in the OTC market through dealers³⁸ who become market makers³⁹ in that security. A subsidiary of the National Association of Securities Dealers, Inc. ("NASD"), NASD Regulation, Inc., is the organization charged with regulating the OTC market.⁴⁰

Today, quotations for most OTC equity trading are handled through the NASDAQ system.⁴¹ In order to trade on NASDAQ, a security must be registered with the SEC pursuant to section 12(g) of the Exchange Act.⁴² Recently, NASDAQ has experienced exponential growth. In 1994, "trading volume exceeded 74.3 billion shares (more than twice 1990 levels), with a value of \$1.45 trillion (three times 1990 levels)."⁴³ In the aggregate, trading in NASDAQ stocks renders it the second largest market in the United States.⁴⁴ Much of

35. For example, the NYSE requires 1.1 million publicly held shares; 2000 holders of 100 shares or more; an aggregate market value of \$18 million for publicly held shares; and a demonstrated earning power under certain competitive conditions. *See id.* at 409.

36. *See id.* at 604.

37. *See id.* at 617. The OTC market is "[a] widespread aggregation of dealers who make markets in many different securities." DAVID L. SCOTT, WALL STREET WORDS 269 (2d ed. 1998). Unlike the exchanges where trading occurs in one physical location, OTC trading occurs through electronic negotiations between buyers and sellers. *See id.*

38. Generally, a dealer is "any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." 15 U.S.C. § 77b(12) (1994).

39. A market maker is a person or firm who or which continuously "buys and sells a security for one's own account." SCOTT, *supra* note 37, at 227. "[D]ealers in the over-the-counter market are market makers." *Id.*

40. *See id.* at 244.

41. *See id.* at 243.

42. *See* 15 U.S.C. § 78f (1994).

43. LOSS & SELIGMAN, *supra* note 30, at 620.

44. *See id.*

this growth can be attributed to recent technological advances, particularly "automated order routing and execution functions."⁴⁵

If a publicly traded company does not meet NASDAQ or exchange listing requirements, its shares are bought and sold over-the-counter.⁴⁶ Previously, price quotes for shares of these OTC companies, generally referred to as penny stocks,⁴⁷ were reported exclusively in daily "pink sheets"⁴⁸ published for broker-dealers by a private corporation, the National Quotations Bureau. Today, pink sheets are being replaced by the computerized OTC Bulletin Board⁴⁹ operated by NASDAQ. The OTC Bulletin Board displays real-time quotes and last sale prices for nearly 6,000 companies.⁵⁰ However, in contrast to the exchanges or NASDAQ, these OTC companies *are not subject to any financial reporting or disclosure requirements prior to inclusion on the OTC Bulletin Board*. In other words, an investor will not be able to obtain any type of reliable information on the issuer, its business, or the particular securities issue.

The term "micro cap" generally refers to the stock of any company with comparatively low capitalization, regardless of its price and where it is traded.⁵¹ The category of micro cap stocks is broader

45. SEC, *Report to Congress: Impact of Recent Technological Advances on the Securities Markets* (1997) available in *Securities and Exchange Commission* (visited Feb. 16, 1999) <<http://www.sec.gov/news/studies/techrp97.htm>> [hereinafter *SEC Report*].

46. *See id.*

47. Generally, a penny stock is defined as an equity security not listed on NASDAQ or a national exchange and either 1) has a price per share of less than \$5; or 2) the issuer has net tangible assets of less than \$2 million, if the issuer has been in continuous operation for at least three years; or which are less than \$5 million, if the issuer has been in continuous operation for less than three years; or whose average revenues are less than \$6 million for the last three years. *See* 15 U.S.C. § 78c(a)(51)(A) (1994); 17 C.F.R. § 240.3a51-1 (1996).

48. Pink sheets are the daily sheets which contain "wholesale price quotations for thousands of over-the-counter stocks as listed by dealers who act as market makers in the individual securities." SCOTT, *supra* note 37, at 279.

49. *See* LOSS & SELIGMAN, *supra* note 30, at 618.

50. *See* SEC Report, *supra* note 45.

51. *See* Concerning Fraud in the "Micro Cap" Market: Before the Permanent Subcomm. on Investigations, Comm. on Governmental Affairs, at 3-4 n.1 (testimony of Arthur Levitt, Chairman, SEC) available in *Securities and Exchange Commission, News* (visited Feb. 16, 1999) <<http://www.sec.gov/news/testimony/tsty1497.txt>> [hereinafter *Fraud in the Micro Cap Market*].

than the penny stock classification. Thus, the term micro cap includes penny stocks. Most, if not all, micro cap stocks are quoted on NASDAQ's OTC Bulletin Board, in the pink sheets, and on the NASDAQ Small Cap Market.⁵² The huge increase in public participation in the securities markets, coupled with increasing Internet use, provides an increased opportunity to manipulate and abuse market prices of such stocks. Micro cap shares are especially prone to manipulation because little, if any, information exists about the issuers. The investors who purchase such stock tend to be unsophisticated; therefore, it is probable that broker-dealers, issuers and promoters can successfully manipulate micro cap stocks without much suspicion. The result is unfortunate—corporate insiders or affiliates get rich quick while innocent investors lose their money.

III. CLASSIC MARKET MANIPULATION

A. Traditional Manipulative Conduct

Generally, and as defined under the federal securities laws, market manipulation means "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."⁵³ However, the crime is not limited to certain deceitful practices. Practices which create the false impression that certain market activity is occurring—when in fact such activity is unrelated to actual supply and demand—are manipulative; clearly, tampering with the stock price itself is also manipulative.⁵⁴

Even before securities laws were enacted, courts at common law honored the principle that the proper functioning of a securities exchange depends on the existence of a free market.⁵⁵ In *United States*

The federal securities laws do not define the term "micro cap," but Lipper Analytical Services classifies companies with market capitalizations of less than \$300 million as micro caps. *See id.*

52. *See id.* at 3 n.4.

53. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976); *see also Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1997) ("[M]anipulation refers generally to practices . . . that are intended to mislead investors by artificially affecting market activity.").

54. *See Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979).

55. *See LOSS & SELIGMAN*, *supra* note 30, at 1531.

v. *Brown*,⁵⁶ Judge Woolsey clearly articulated the free market concept:

When an outsider, a member of the public, reads the price quotations of a stock listed on an exchange, he is justified in supposing that the quoted price is an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length in a free and open market on the exchange, and so represents a true chancering of the market value of that stock thereon under the process of attrition due to supply operating against demand.⁵⁷

The classic characteristic of most market manipulations is "behavior that has the effect of artificially distorting the market price of the stock in question, typically by appeals to the speculative impulses of other investors."⁵⁸ This statement is premised on the assumption that market prices and trading behavior are themselves items of material information that investors use to make "buy" or "sell" decisions.⁵⁹ Essentially, it is the "economic function of a securities exchange that it be a free market—free of the artificiality of manipulation."⁶⁰ Thus, provisions of the Exchange Act prohibiting market manipulation reflect Congress's desire to assure the integrity of market price information.⁶¹

Congress passed the Securities Act and the Exchange Act largely in response to market manipulation and deceitful practices in the early part of the twentieth century.⁶² In the early 1930s, Senate

56. 5 F. Supp. 81 (S.D.N.Y. 1933), *aff'd on other grounds*, 79 F.2d 321 (2d Cir. 1935), *cert. denied sub nom.*, *McCarthy v. United States*, 296 U.S. 650 (1935).

57. *Brown*, 5 F. Supp. at 85.

58. JAMES D. COX ET AL., *SECURITIES REGULATION* 656 (2d ed. 1997).

59. *See id.*

60. LOSS & SELIGMAN, *supra* note 30, at 930.

61. *See* 15 U.S.C. § 78b (1994), which states:

[T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions . . . , including [the imposition of] requirements necessary to make such regulation and control reasonably complete and effective, in order to . . . insure the maintenance of fair and honest markets in such transactions.

62. *See* Norman S. Poser, *Stock Market Manipulation and Corporate Con-*

investigations into the securities markets revealed an increase in "pool" operations where investors would pump up stock prices through a series of well-timed purchases, then unload their holdings on the unsuspecting public before prices dropped.⁶³

The SEC found further signs of market manipulation when the traditional boiler room⁶⁴ became a concern in the late 1950s, after the SEC became aware of a large number of such operations springing up around the country.⁶⁵ Describing the practice as a "selling method[] which represent[s] the antithesis of fair dealing," the SEC noted that such selling techniques were not "conducive to an unhurried, informed and careful consideration of the investment factors applicable to the securities involved."⁶⁶

Mainly using telephone technology, boiler rooms usually employ broker-dealers who use high-pressure tactics. Such operations fall under

the ban of the fraud provisions on alternate theories: (1) because those provisions "contemplate, at the least, that recommendations of a security made to proposed purchasers shall have a reasonable basis and that they shall be accompanied by disclosure of known or easily ascertainable facts bearing upon the justification for the representations," and (2) because of the *failure to disclose* to customers "the lack of adequate financial information or caution them as to the risk involved in purchasing the stock without such information."⁶⁷

trol Transactions, 40 U. MIAMI L. REV. 671, 691-97 (1986).

63. *See id.* at 696.

64. A typical boiler room operation involves dozens of salespeople packed into a room, sitting at banks of telephones, and making hundreds of unsolicited "cold" calls a day to potential customers. *See* Marcy Gordon, "Boiler Room" *Investment Scams Targeted by States*, ORANGE COUNTY REG., July 24, 1998, at C3. Despite the emergence of the Internet, traditional boiler rooms still exist and continue to thrive. *See id.*

65. *See* Proposed Rule X-15C2-6 under Securities Exchange Act, Exchange Act Release No. 6885, [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,862, at 81,200-01 n.2 (Aug. 16, 1962) (*quoting Mac Robbins & Co.*, Exchange Act Release No. 6846 [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,853, at 81,166-67 (July 11, 1962)).

66. *Id.*

67. LOSS & SELIGMAN, *supra* note 30, at 896-97 (quoting *Feeney v. SEC*, 564 F.2d 260, 262 (8th Cir. 1977), *cert. denied*, 435 U.S. 969 (1978)).

B. Applicable Provisions of the Federal Securities Laws

In the area of market manipulation, Congress did not mean to derogate from the common law by enacting federal statutes. The purpose of these statutes "has been to give a greater degree of definiteness to the concept of manipulation and to supply an enforcement and preventive mechanism."⁶⁸ The statutory scheme developed through fraud theories borrowed from the common law; the open market concept developed through English and American common law.⁶⁹

The basic antifraud provisions, section 17(a) of the Securities Act⁷⁰ and sections 10(b) and 15(c) of the Exchange Act,⁷¹ have been used to combat certain manipulative practices. Section 17(a), long termed the "grandfather" of all antifraud provisions, creates three different offenses:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.⁷²

68. *Id.* at 934-35.

69. *See id.* at 935.

70. 15 U.S.C. §§ 77a-77aa (1994).

71. 15 U.S.C. §§ 78a-78ll (1994). Section 15(c)(1) of the Exchange Act prohibits broker-dealers from making use of interstate commerce "to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security otherwise than on a national securities exchange of which it is a member by means of any manipulative, deceptive, or other fraudulent device or contrivance." 15 U.S.C. § 78o(c)(1)(A) (1994). This statute is limited to broker-dealer over-the-counter transactions.

72. 15 U.S.C. § 77q (1994).

The provisions actually use the word "manipulative," which the Supreme Court has noted is a virtual "term of art," reflecting Congress's intention "to prohibit the full range of ingenious devices that might be used to manipulate securities prices."⁷³ Thus, section 9 of the Exchange Act, outlined below, is supplemented by section 10(b),⁷⁴ and rules 10b-5⁷⁵ and 10b-1⁷⁶ promulgated thereunder, which may have applicability in a market manipulation case. Section 10(b) makes it unlawful to

use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.⁷⁷

Extensive hearings preceded passage of the Exchange Act. The most relevant discussion of the provision that later became section 10(b) described the section as a "catchall" provision which would allow the SEC to "deal with new manipulative devices."⁷⁸ However, conduct such as filing false financial reports, issuing misleading press releases, or insider trading is not necessarily manipulative even though it may have caused the price of a security to change or may have violated some other securities law.⁷⁹ Rather, "[m]anipulative conduct consists of 'practices . . . intended to mislead investors by artificially affecting market activity.'"⁸⁰

73. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977).

74. 15 U.S.C. § 78j(b) (1994).

75. 17 C.F.R. § 240.10b-5 (1998).

76. 17 C.F.R. § 240.10b-1 (1998).

77. 15 U.S.C. § 78j(b) (1994).

78. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 202-03 (1976) (citing *Hearings on H.R. 7852 and 8720 Before the House Comm. On Interstate and Foreign Commerce*, 73d Cong. 115 (1974) (statement of Thomas G. Concoran, spokesman for the drafters of what became § 10(b))).

79. *See Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979).

80. *Id.* (quoting *Santa Fe Indus., Inc.*, 430 U.S. at 476.)

1. Manipulation of the securities exchanges

A number of Exchange Act sections, discussed below, prohibit market manipulation through the dissemination of false or misleading information. These laws can be used to prosecute issuers or other third parties who have manipulated market prices by posting false information on the Internet.

Section 9(a)(1) prohibits "wash sales" and matched orders; in essence, transactions where the same person—or an affiliate—is for all practical purposes both purchaser and seller so that the sale only has the appearance of a bona fide transaction.⁸¹ A pool of investors—probably insiders—can engage in a series of wash sales at progressively higher prices, hoping to lure investors to purchase the stock in response to an illusion that the price is on a steady upward trend. Then, as can be expected, the pool of investors can dump the stock.

The broadest prohibition against market manipulation appears in section 9(a)(2), which makes it unlawful for any person

[t]o effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such a security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security *by others*.⁸²

Effectively, section 9(a)(2) acts as a catch-all prohibition. The purpose of section 9(a)(2), "the very heart of the Act,"⁸³ is to prohibit every "device used to persuade the public that activity in a security is the reflection of a genuine demand instead of a mirage."⁸⁴ In essence, manipulation is a form of deception because a person "who purchases or sells securities for the purpose of inducing other persons to trade is necessarily deceiving those persons into believing that the manipulator's purchases or sales are a bona fide expression of supply and demand in the market"⁸⁵

81. See 15 U.S.C. § 78i(a)(1) (1994).

82. 15 U.S.C. § 78i(a)(2) (1994) (emphasis added).

83. SEC REPORT ON PROPOSALS FOR AMENDMENTS, *supra* note 2.

84. *Id.* at 54.

85. Poser, *supra* note 62, at 704.

The first element of a violation under section 9(a)(2) requires that one who initiates a transaction "effect" it.⁸⁶ Also, the "series" requirement is satisfied by as few as three purchases,⁸⁷ or perhaps even two may suffice. The term "transaction" has been interpreted to broaden the scope from mere purchases or sales; in an auction market, the placing of bids, even if never met by sellers, "may be as effective an influence on price as a completed sale" because the result forces bidders to raise their bids.⁸⁸

A showing that one has created either actual or apparent trading activity or raised or depressed the stock price satisfies the second element of a section 9(a)(2).⁸⁹ It is apparent from case law that a price change is required, albeit that a small price change may suffice.⁹⁰

The third, final, and most burdensome evidentiary element of section 9(a)(2) involves the requirement of showing a *purpose to induce others* to buy or sell. The SEC has said that because "it is impossible to probe into the depths of a man's mind, it is necessary in the usual case . . . that the finding of manipulative purpose be based on inferences drawn from circumstantial evidence."⁹¹ In other words, motive to manipulate plus a series of transactions establishes a *prima facie* showing of purpose and shifts the burden to the defendant.⁹²

The decision to create an express civil cause of action in section 9(e) demonstrates that Congress was concerned with the practices prohibited in section 9(a)(2). Section 9(e) authorizes any person who purchases a security at a price that is affected by conduct in violation of section 9(a) to sue any person who "willfully participates."⁹³ If

86. See 15 U.S.C. § 78i(a)(2).

87. See *Kidder, Peabody & Co.*, 18 S.E.C. 559 (1945).

88. *Id.*

89. See *United States v. Stein*, 456 F.2d 844, 850 (2d Cir. 1972).

90. See *LOSS & SELIGMAN*, *supra* note 30, at 939 (citing *Stein*, 456 F.2d at 846).

91. *Federal Corp.*, 25 S.E.C. 227 (1947); see generally *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983) (noting that proof of scienter from circumstantial evidence is permitted).

92. See *Alabama Farm Bureau Mut. Cas. Co. v. American Fidelity Life Ins. Co.*, 606 F.2d 602, 616 (5th Cir. 1979), *cert. denied*, 449 U.S. 820 (1980).

93. 15 U.S.C. § 78i(e) (1994).

market manipulation occurs for investment purposes, *i.e.*, where the investor has not acted for the "purpose of inducing the purchase or sale of such security *by others*,"⁹⁴ but has driven the stock price up in order to dump his or her own shares, it is arguable whether section 9(a)(2) will apply. In such an instance, the investor can be prosecuted under Rule 10b-5.⁹⁵

Even in 9(a)(2) cases, the SEC usually takes the extra step and proves nondisclosure in order to bring the manipulation within conventional fraud theories.⁹⁶ In fact, the SEC began de-emphasizing the section 9(a)(2) approach in the late 1950s, although it was never abandoned.⁹⁷ However, even in instances where application of section 9 is proper, the SEC and the courts have held that the antifraud provisions are also violated when securities are sold at manipulated prices without disclosure of the manipulation.⁹⁸ Such was the case in

94. 15 U.S.C. § 78i(a)(2) (1994) (emphasis added).

95. *See* United States v. Mulheren, 938 F.2d 364, 368-72 (2d Cir. 1991). Moreover, section 9(a)(3) addresses indirect manipulation by third parties, such as agents paid by market participants, who manipulate stock prices by broadcasting false or misleading information. This section specifically makes it unlawful for a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to induce the purchase or sale of any security registered on a national securities exchange by the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the prices of such security. *See* 15 U.S.C. § 78i(a)(3) (1994).

Furthermore, section 9(a)(4) prohibits brokers, dealers, or other persons selling or offering for sale, or purchasing or offering to purchase, a nationally registered security from inducing the purchase or sale by means of any statement that was, in light of surrounding circumstances, "false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false and misleading." 15 U.S.C. § 78i(a)(4) (1994). This practice of spreading rumors or paying someone else to "tout" the stock when the broker, dealer or other offeror is trying to unload it has, as its only objective, the goal of fueling investor enthusiasm. *See* Poser, *supra* note 62, at 696.

Section 9(a)(5) makes it equally unlawful for any person to induce the purchase or sale of a registered security for consideration received from a broker or dealer or from any other person selling or buying, or offering to sell or buy, a *registered* security. *See* 15 U.S.C. § 78i(a)(5) (1994).

96. *See id.*

97. *See* LOSS & SELIGMAN, *supra* note 30, at 944.

98. *See id.* at 943.

Barrett & Co., where the SEC strengthened its holding through a reference to previous decisions where such nondisclosure constituted omission of a material fact and fraud on the purchasers.⁹⁹

In October 1988, the SEC announced that it would form a task force on penny stock manipulation, which at the time had become a more "widespread abuse in the marketplace."¹⁰⁰ Interestingly, and at around the same time, the SEC initiated a series of significant *registered* stock manipulation cases against Boyd L. Jefferies,¹⁰¹ Drexel Burnham Lambert, Inc.,¹⁰² and Michael Milken,¹⁰³ among others. Clearly, market manipulation under section 9(a)(2) is not a statutory dinosaur, even if its muscles are rarely flexed.

2. Manipulation of the over-the-counter market

Unlike the section 9 provisions enacted by Congress to regulate manipulation of registered securities,¹⁰⁴ the only statutory bases for attacking manipulation of unregistered securities are the general antifraud provisions of the Exchange Act,¹⁰⁵ together with section 17 of the Act.¹⁰⁶ Regardless, the SEC has attempted to put over-the-counter manipulation on the same level as manipulation of the exchange markets. In *Barrett & Co.*,¹⁰⁷ the SEC concluded that there is no reasonable distinction . . . between manipulation of over-the-counter prices and manipulation of prices on a national securities exchange, and that both are condemned as fraudulent by the Securities Exchange Act and, in fact, were fraudulent at common law We believe that the Securities Exchange Act contemplates that Section 15(c)(1) affords to the over-the-counter market at least as great a

99. See *Barrett & Co.*, 9 S.E.C. 319, 328 (1941).

100. William R. McLucas & Alma M. Angotti, *Market Manipulation*, 22 REV. OF SEC. & COMMODITIES REG. 103, 103 (1989).

101. See SEC v. Jefferies, Fed. Sec. L. Rep. (CCH) ¶ 93,171 (Mar. 19, 1987).

102. See SEC v. Drexel Burnham Lambert, Inc., Fed. Sec. L. Rep. (CCH) ¶ 94,474 (June 20, 1989).

103. See SEC v. Milken, Fed. Sec. L. Rep. (CCH) ¶ 95,200 (Apr. 24, 1990).

104. See 15 U.S.C. § 78i(f) (1994). The text of § 9 expressly renders § 9(a) inapplicable to federally exempted securities. See *id.*

105. See, e.g., 15 U.S.C. §§ 78j(b) (1994).

106. See 15 U.S.C. § 77q (1994).

107. 9 S.E.C. 319 (1941).

degree of protection against manipulation or attempted control as is afforded to the exchange market by Section 9(a).¹⁰⁸

Where application of the antifraud provisions is supplementary to section 9(a)(2) cases, sections 10(b) of the Exchange Act and 17(a) of the Act are essential in over-the-counter cases where section 9 is inapplicable.¹⁰⁹ Yet, section 17(a) of the Act and sections 9(a) and 15(c) of the Exchange Act leave the following two gaps: fraud in a *purchase* unless effected by a broker-dealer over-the-counter, or by any person buying a registered security for the purpose of inducing its purchase by others.¹¹⁰

Rule 10b-5, promulgated under section 10(b), borrows the language of section 17(a), except for the reference to obtaining money or property and the substitution of "act" for 17(a)'s "transaction," and applies that language "in connection with the purchase or sale of any security".¹¹¹

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,

- (1) to employ any device, scheme, or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of circumstances under which they were made, not misleading, or
- (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.¹¹²

108. *Id.*

109. *See* LOSS & SELIGMAN, *supra* note 30, at 944.

110. *See id.* at 778.

111. *See id.* at 748.

112. 17 C.F.R. § 240.10b-5 (1998).

IV. THE INTERNET: A NEW MEDIUM FOR MARKET MANIPULATION

A. On-line Manipulative Conduct

Although market manipulation was a phenomenon of the early part of the century, it has spread in unprecedented ways with the emergence of the Internet. Unlike traditional boiler rooms where perpetrators are usually unscrupulous brokerage firms,¹¹³ the Internet introduces a greater opportunity for other market participants to become involved in the practice of market manipulation. The Internet offers manipulators ready access to on-line newsletters, bulletin boards, chat rooms, and e-mail, all of which make the execution of market manipulation easier than ever before. This fact is evidenced in the numerous instances of on-line market manipulation discussed below.

The Internet delivers both economic and informational advantages and, almost inevitably, disadvantages. Although the benefits of a global market undoubtedly outweigh the burdens, the Internet brings an increased opportunity for exploitation. For example, despite the fact that the Internet offers issuers an enhanced ability to raise capital in a cost efficient manner, it also makes it easier for issuers, broker-dealers, or other persons, to manipulate stock prices and remain undetected.¹¹⁴ Today, both short- and long-term investors can easily reach market participants worldwide and use false information in an attempt to manipulate stock prices.

Most Internet users have user names,¹¹⁵ pseudonyms that allow users a distinct on-line identity and permit them to preserve their anonymity and privacy. A user name or e-mail address¹¹⁶ is usually

113. See Perry W. Jost, *Letting the Steam Out of Boiler Room Operations: Added Restrictions on Broker-Dealer Penny Stock Recommendations Imposed Under New SEC "Cold Calling" Rule 15c2-6*, 22 RUTGERS L.J. 727, 727 (1991).

114. See Coffee, *supra* note 7, at 1201.

115. To connect to the Internet a person needs to choose an Internet service provider ("ISP"). See YOUNG, *supra* note 8, at 14. The ISP then requires that the person choose a user name, which is usually comprised of any combination of a person's name or initials. See *id.* at 16. Some users, however, choose "fanciful" names or names that relate to hobbies or interests. *Id.*

116. An e-mail address consists of the user name and the host domain name, *i.e.*, the name of a computer owned by a company or Internet service, joined by

the only on-line indicator of a user's identity. It follows that, with relative ease, unscrupulous investors can make messages which contain false information look real and credible; moreover, a user who employs one of the following methods can render misleading messages virtually untraceable. Such an act is within the capacity of even novice Internet users. In particular, but by no means exclusively, unscrupulous promoters may use the following two proven methods to fool the legitimate investor.

First, users may disguise their true identities by false pretense or anonymity.¹¹⁷ For example, by pretending to be a company insider when in actuality the user is a short term investor in the company's stock, the user can disguise his or her identity and post false or inaccurate information on the Internet to artificially hype the stock.¹¹⁸ "In the more sophisticated instance, the user sends postings via a 'remailer' or other 'anonymizing' tool, which provides anonymous email addresses to users who wish to hide their true identities."¹¹⁹ With little effort and minimal expense, anonymizing tools delete the identifying information from message headers,¹²⁰ thereby defeating the possibility of tracing a message to its point of origin.¹²¹

The second method, commonly known as "spoofing," entails altering or falsifying e-mails.¹²² By using a real person's identity or user identification for the purpose of impersonation, an imposter can read and alter that person's e-mail or newsgroup posting.¹²³ As is commonly understood, the Internet is far from private.¹²⁴ This fact is evidenced by the availability of "packet sniffer" programs that

the "at" sign (@). *See id.* at 104.

117. *See Cella & Stark, supra* note 29, at 826.

118. *See id.*

119. *Id.*

120. Message headers are the electronic equivalent of envelopes. Headers include the electronic addresses of the recipient and sender, the date and time the message was sent, and other descriptive information about the message. *See YOUNG, supra* note 8, at 106-07.

121. *See Cella & Stark, supra* note 29, at 826.

122. *See id.*

123. *See id.*

124. The Internet also raises privacy issues, which are beyond the scope of this Comment. For a comprehensive overview of possible on-line privacy issues see FEDERAL TRADE COMMISSION, *Privacy Online: A Report to Congress*, June, 1998, available in *Federal Trade Commission, Reports* (visited Jan. 25, 1999) <<http://www.ftc.gov/reports/privacy3/toc.htm>>.

intercept passwords typed in by users.¹²⁵ Programs that monitor keystrokes—the on-line equivalent of wire-tapping a phone line—allow a “cracker”¹²⁶ to deduce identifying information and forge messages that appear to be from someone else.¹²⁷ Armed with such information, an unscrupulous user may, for example, create a posting that is seemingly authored by a public company officer in order to manipulate the company’s stock. Ostensibly, an investor may recognize the named author of a particular posting and trust the information contained therein as accurate; however, the author of the posting may not actually be the purported company official but rather an impostor attempting to manipulate the stock price.¹²⁸

Clearly, a manipulator can reach a much larger audience via the Internet than by working a telephone in a traditional boiler room. “Whereas the traditional ‘boiler room’ promoter might reach several hundred customers through fraudulent phone calls and/or mailings, the fraudulent promoter on the Internet might reach tens of thousands—and at virtually no cost.”¹²⁹

SEC enforcement officials actively monitor the Internet’s various forums for any indication of market manipulation.¹³⁰ In theory, market manipulation on the Internet should be more easily detectable than through the telephone, which limits the SEC’s ability to catch the classic boiler room promoter to situations where an injured victim complains after the harm is inflicted. However, special problems arise when market manipulation occurs on the Internet.

First, the promoter can hide his or her identity on the Internet and make statements on an anonymous or false basis, thus making it difficult to identify and prosecute the actual wrongdoer. Second, the manipulative statement can originate outside the United States, beyond the SEC’s reach.¹³¹

125. See Cella & Stark, *supra* note 29, at 826.

126. A cracker, as opposed to a hacker whose entire life is immersed in computing, is one who focuses on illegal computer activity. See DANIEL P. DERN, *THE INTERNET GUIDE FOR NEW USERS* 378 (1994).

127. See Cella & Stark, *supra* note 29, at 826.

128. See *id.* at 826-27.

129. Coffee, *supra* note 7, at 1223.

130. See *infra* Part IV.

131. See Coffee, *supra* note 7, at 1201-02.

One particular characteristic of the Internet as a medium for disseminating information is that it can give a legitimate appearance to otherwise illegitimate information.¹³² The Internet allows manipulators who have set up Web sites or bulletin boards to establish electronic links through which users can access previously published legitimate material. The manipulator thereby increases his or her credibility by associating the Web site or bulletin board with legitimate information, such as reports and other well-recognized periodical information. For instance, on April 7, 1999, an anonymous user posted a false message on a bulletin board and provided a link to a site that looked like that of Bloomberg News.¹³³ Indeed, the Internet "even allows a site-holder to link a Web page with a Web page prepared by a regulator."¹³⁴

The new "cyber"¹³⁵ boiler rooms allow scam artists to conduct sophisticated market manipulations at almost no cost over the Internet from the comfort of their own homes. In four easy steps, a manipulator can consummate the entire fraud.¹³⁶ The first step is to set up a site or home page where potential investors can find out about the issuer.¹³⁷ In step two, the manipulator, using bulk e-mail or a

132. See International Organization of Securities Commissions, *Report on Enforcement Issues Raised by the Increasing Use of Electronic Networks in the Securities and Futures Field*, B-1037 P.L.I. CORP. L. & PRAC. 225, 227 (1998).

133. See Jonathan Gaw, *Internet Hoax Sends O.C. Tech Stock Up 31%*, L.A. TIMES, Apr. 8, 1999, at A1. See discussion *infra* Part IV.B.2.

134. International Organization of Securities Commissions, *supra* note 132, at 228.

135. Coined by science fiction writer William Gibson and now part of the common vernacular, "cyberspace" describes the world of electronic communications. See WILLIAM GIBSON, *NEUROMANCER* 4 (1984). The term is also used as an adjective and "has attained such exalted pop culture status that it has spawned new derivative terms: cyberchat, cyberphobia, cybersex." Sam Puathasnanon, *Cyberspace and Personal Jurisdiction: The Problem of Using Internet Contacts to Establish Minimum Contacts*, 31 LOY. L.A. L. REV. 691, 691 (1998).

136. See John Reed Stark, *Tombstones: The Internet's Impact Upon SEC Rules of Engagement*, INSIGHTS, Feb. 1998, at 10.

137. See *id.* Web space can be allocated to the manipulator for free by most Internet service providers. With graphics, sound, and video downloaded from the Internet, the manipulator can easily post a wide range of phony financial statements and information that lure investors into purchasing securities. See *id.*

spamming program, personally contacts potential investors regarding an investment opportunity.¹³⁸ In step three, the manipulator begins a "buzz" about the issuer and its shares by posting false information to bulletin boards, newsgroups, and discussion forums.¹³⁹ Finally, in step four, the manipulator strengthens the buzz by employing an Internet investment newsletter.¹⁴⁰ It is that easy to hype the stock, and easier still to sell the stock back into the exchanges or over-the-counter markets at a profit and reap the financial rewards of having inflated the stock price.

B. Susceptibility of Micro Cap Stocks

Smaller companies' stocks, trading in a less than fully efficient market, are uniquely vulnerable to rumors and price manipulation. John Reed Stark, Chief of the SEC's new Office of Internet Enforcement ("OIE"), has noted that many of the complaints fielded by the SEC regard small, often speculative companies whose shares are quoted on the OTC bulletin board.¹⁴¹ Often, shares of small cap¹⁴² companies which have a small public float of available shares and low prices are prime targets for "pump-and-dump" schemes.¹⁴³

Most micro cap stocks are exempt from federal registration requirements. As such, these securities are traded over-the-counter and a limited number of brokers control the market.¹⁴⁴ In the past, registered brokers peddled such stocks; today, micro cap stocks are

138. *See id.* at 11. The manipulator can use a "mining" or "extractor" program that automatically collects e-mail addresses from all over the Internet to compile a list of users who will receive the spam. *See id.*

139. *See id.* The manipulator can also respond to his or her own postings under different user names to create the illusion that people are carrying on the discussion. *See id.*

140. *See id.* The manipulator can personally construct the newsletter to tout the stock or bribe an unscrupulous online investment newsletter to feature the issuer's stock. *See id.*

141. *See* Jason Anders, *Consider the Source*, WALL ST. J., Sept. 8, 1998, at R16.

142. A small cap company is one with "a relatively small number of shares outstanding. The stock of [small cap companies] tends to have volatile market prices." The term "small cap" is often used interchangeably with the term "micro cap." *See* SCOTT, *supra* note 37, at 352-53.

143. *See* Anders, *supra* note 141; *see* discussion *infra* Part IV.B.1.

144. *See* *Fraud in the Micro Cap Market*, *supra* note 51, at 6.

increasingly being touted on-line by promoters paid by the issuer.¹⁴⁵ Typically, company promoters and often issuer insiders hold large amounts of stock and profit substantially when stock prices rise after intense touting.¹⁴⁶

In October 1998, recognizing the susceptibility of small issues, the SEC charged forty-four companies and individuals for illegally touting small company stocks on-line.¹⁴⁷ In its first Internet securities fraud "sweep," the SEC filed twenty-three enforcement actions against the forty-four stock promoters, Web site operators, and newsletter publishers who violated the securities laws through use of spam, on-line newsletters, message boards, and Web sites. Most defendants misrepresented companies' prospects and failed to disclose that they were being compensated by issuers to tout the stock.¹⁴⁸ The stock prices of more than 235 micro cap companies were affected by the alleged illegal activity.¹⁴⁹

Commenting on the "Internet cases," SEC Enforcement Chief Richard Walker said that traditional, penny stock, boiler room operators have traded cold calling for cyberspace and that the new actions and complaints are aimed at sending a message to the unscrupulous.¹⁵⁰

There is a fine line between lawful stock promoting and fraud. In the Internet cases, "[p]romoters often presented company information as unbiased research and issued enthusiastic 'buy' recommendations without disclosing that they received cash and stock for their services."¹⁵¹ Arguably, the SEC's first sweep of on-line fraud was intended to have a deterrent effect on would-be manipulators.

In February 1999, the SEC continued its crackdown on Internet securities fraud and charged another thirteen defendants with misrepresenting the prospects of fifty-six companies in a second round of

145. *See id.*

146. *See id.*

147. *See* Michael Schroeder & Rebecca Buckman, *U.S. Attacks Stock Fraud on Internet: SEC Hits Promoters Touting Small Issues*, WALL ST. J., Oct. 29, 1998, at C1.

148. *See id.*

149. *See id.*

150. *See id.*

151. *Id.*

enforcement activity.¹⁵² In its latest sweep, in May 1999, the SEC accused twenty-six companies and individuals for illegally offering unregistered securities on-line.¹⁵³ After these three Internet fraud sweeps, it is apparent that SEC strategy is to bring actions simultaneously in order to reap the maximum amount of publicity to the agency's enforcement efforts.¹⁵⁴ The SEC has increased surveillance; however, SEC officials have stated that the public should not be stunned if on-line fraud continues because the agency cannot be expected to stamp it out.¹⁵⁵

1. On-line newsletters

Hundreds of investment newsletters have appeared virtually overnight on the Internet.¹⁵⁶ Many such publications are legitimate, do not charge a fee for offering seemingly unbiased information to investors,¹⁵⁷ and provide insight into featured companies and recommend "stock picks of the month."¹⁵⁸ While such information may play an arguably valuable role in investment decisions, some on-line newsletters are tools for manipulative activity.¹⁵⁹

Some companies pay promoters in cash or securities to recommend the company's stock in on-line newsletters. Although the practice is legal, federal law requires promoters who tout stock in a newsletter to disclose the fact of payment and the amount.¹⁶⁰

152. See Michael Schroeder & Rebecca Buckman, *SEC Cracks Down on Internet Securities Deals*, WALL ST. J., May 13, 1999, at C1.

153. See *id.*

154. See *id.*

155. See *id.* (quoting Richard Walker, director of the SEC's enforcement division).

156. See *Internet Fraud: Tips for Checking Out Newsletters* (last modified Oct. 27, 1998) <<http://www.sec.gov/consumer/news1chk.htm>> [hereinafter *Tips*].

157. See *id.*

158. See, e.g., *The Future Superstock* (visited Mar. 15, 1999) <<http://www.futuresuperstock.com>>.

159. See *Internet Fraud: How to Avoid Internet Investment Scams* (last modified Dec. 17, 1998) <<http://www.sec.gov/consumer/cyberfr.htm>> [hereinafter *Scams*].

160. See 15 U.S.C. § 77q(b) (1994). Section 77q(b) of the Securities Act of 1933 makes it "unlawful for any person . . . to publish . . . or circulate any notice, circular, advertisement . . . or communication which . . . describes [a] security for a consideration received or to be received, directly or indirectly,

However, many promoters fail to disclose the requisite information.¹⁶¹

The SEC has brought many cases where the issuer had experienced a lot of "Usenet hype," the seminal Internet market manipulation case being *SEC v. Charles O. Huttoe*.¹⁶² *Huttoe* is a prime example of the classic "pump-and-dump"¹⁶³ scheme where owners of thinly traded stocks pumped up demand for shares through on-line newsletters, chat rooms, and bulletin boards, and then sold the shares at inflated prices. Once the manipulators sell off their shares and stop hyping the stock, the price falls and innocent investors lose money.¹⁶⁴ This scam is easily analogized as a high-tech version of the penny stock boiler room. This manipulative scheme is often used with small, thinly traded companies because it is easier to manipulate a stock when there is little or no information available about the company. Moreover, the opportunity to manipulate stock prices increases with the anonymity Internet communication allows; thus, ruthless promoters can more easily "pump-and-dump" stocks.

Huttoe was the chairman of the board and chief executive officer of Systems of Excellence ("SOE"), a manufacturer and distributor of video teleconferencing equipment.¹⁶⁵ Huttoe distributed millions of SOE shares to other corporations and family members,

from an issuer . . . without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof." *Id.*

161. See Schroeder & Buckman, *supra* note 152 (reporting the SEC accused 44 companies of "not fully disclosing that they were being paid by the companies to tout their stocks over the Internet.").

162. *SEC, Litigation Release No. 15153, Nov. 7, 1996* (visited Apr. 9, 1999) <<http://www.sec.gov/enforce/litigrel/lr15153.txt>>. The defendant consented to entry of a final judgment of permanent injunction prohibiting him from violating section 17(a) of the Act and section 10(b) of the Exchange Act, among other things. See *SEC, Litigation Release No. 15571, Nov. 25, 1997* (visited Apr. 9, 1999) <<http://www.sec.gov/enforce/litigrel/lr15571.txt>>.

163. The signature characteristic of a classic pump-and-dump scheme is a sharp rise in the stock's price and volume followed by a steady decline. See *Portrait of a "Pump-and-Dump"* (visited Feb. 16, 1999) <<http://www.stockdetective.com/pumpndump.asp>>. "Smaller stocks are particularly susceptible to market manipulation by corporate insiders and affiliated parties." *Id.* Usually, unsuspecting investors are lured into purchasing thinly traded, inexpensive stocks through promotions disguised as legitimate, unbiased research with a stated or implicit "buy" recommendation. See *id.*

164. See *Scams, supra* note 159.

165. See *Litigation Release No. 15153, supra* note 162.

manipulated the trading market by issuing materially false and misleading press releases about SOE and its business, and finally sold his shares into the inflated market.¹⁶⁶ The electronic releases announced, among other things, nonexistent "multimillion-dollar sales of SOE products, an acquisition that had not occurred, and false revenue projections for the business."¹⁶⁷ As a result, the defendants allegedly obtained over \$10 million in illegal proceeds.¹⁶⁸

The SEC alleged that the defendants had used the Internet as a means of manipulating the market.¹⁶⁹ Postings concerning SOE in Internet message areas totaled over 10,000.¹⁷⁰ "The SEC filed a total of 32 civil lawsuits alleging market manipulation and five criminal charges."¹⁷¹

In other instances, paid promoters not only withhold the fact that they receive compensation, but misrepresent their independence, track record, and research findings.¹⁷² Notorious promoters have gone as far as "scalping" the stock they are paid to hype, driving up the market price with unfounded recommendations, and then selling their own holdings at high prices for great profit.¹⁷³

In one recent case, the SEC sought an injunction against an Internet newsletter called The Future Superstock ("FSS") for alleged violations of section 17(a) of the Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.¹⁷⁴ FSS recommended to more than 100,000 subscribers approximately twenty-five micro cap stocks that FSS predicted would double or triple in price over the next three to twelve months.¹⁷⁵ "In most instances, the prices of

166. *See id.*

167. Cella & Stark, *supra* note 29, at 843.

168. *See id.*

169. *See id.*

170. *See id.*

171. *Business Center* (CNBC television broadcast, July 13, 1998).

172. For example, the author of SGA Goldstar's on-line "Whisper Stocks" newsletter was sentenced to federal prison after accepting bribes to tout the stock of Systems of Excellence, Inc. *See SEC, Litigation Release No. 15237, Jan. 31, 1997*, (visited Feb. 17, 1999) <<http://www.sec.gov/enforce/litigrel/lr15237.txt>>.

173. *See Scams, supra* note 159.

174. *See SEC, Litigation Release No. 15958, Oct. 27, 1998* (visited Mar. 4, 1999) <<http://www.sec.gov/enforce/litigrel/lr15958.txt>>.

175. *See id.*

recommended securities increased for a short period of time after a recommendation was made in [FSS], after which the prices of those stocks dropped substantially."¹⁷⁶

FSS writer, Bruss, failed to disclose that he routinely sold shares in the issuers he profiled after recommending the public buy the shares; moreover, Bruss made false and misleading statements regarding the success of his past stock picks and falsely represented that he performed research and analysis of issuers profiled.¹⁷⁷

As a result of the manipulative activities of such on-line newsletters, the SEC now offers investors on-line tips for assessing the credibility of investment newsletters.¹⁷⁸

2. On-line bulletin boards and chat rooms

Whether Usenet newsgroups¹⁷⁹ or Web-based discussion forums,¹⁸⁰ on-line bulletin boards are also quickly becoming a popular forum for sharing investment information.¹⁸¹ Generally consisting of "threads" of messages concerning numerous different opportunities, manipulators often hype a company by purporting to reveal inside information about its upcoming announcements, new products, or lucrative contracts.¹⁸² By using the anonymizing tools discussed above or hiding their identities through aliases, manipulators can theoretically create an illusion of widespread interest in a particular stock. Also, a user claiming to be unbiased observer who has carefully

176. *Id.*

177. *See id.*

178. *See Tips*, *supra* note 156. For an example of a site entirely devoted to cautioning investors, see *Stock Detective* (visited Feb. 16, 1999) <<http://www.stockdetective.com>>.

179. Usenet is a distributed system of messages (called postings) that are divided into topical newsgroups. *See YOUNG*, *supra* note 8, at 278. Accessible through the Internet, Usenet is a system of thousands of newsgroups which allows users to exchange information on a huge variety of topics. *See id.* Essentially, users can read a newsgroup's posting, reply to it, and/or post a new message. *See id.*

180. Web discussion boards, or forums, function like Usenet newsgroups. *See id.* at 350. Generally, such forums do not require special software; however, registration with the board operator, which would require disclosure of the user's name and e-mail address, may be necessary before a user can post messages. *See id.*

181. *See Scams*, *supra* note 159.

182. *See id.*

researched a company may turn out to be a company insider, shareholder, or paid promoter.

Chat rooms,¹⁸³ Web-based discussion forums, newsgroups, and other news forums sponsored by on-line service providers are new breeding grounds for users to engage in conversation focused on small stocks that evade much attention from securities analysts.¹⁸⁴ Statements posted on the Internet in such forums can range from mere opinions to subjective predictions and other unsubstantiated rumors—perhaps purporting to have been confirmed by the company—to deliberately fabricated lies.¹⁸⁵ The most common practice involves posting several messages in rapid succession, all repeating the same “prediction.”¹⁸⁶ Whether prearranged or sent by the same person using different aliases, the key point is that the statements are made anonymously, or worse, by investors masking their true identities.¹⁸⁷ The result is an epidemic of false information spreading like wild fire through chat rooms. Consequently, stock prices rise and fall in an increasingly volatile market.¹⁸⁸

183. Commonly referred to as “chatting,” individuals on the Internet can engage in “real time” dialogue. In its simplest form, “chat”

allows one-to-one communications and “Internet Relay Chat” (or IRC) allows two or more [users] to type messages to each other that almost immediately appear on the others’ computer screens. IRC is analogous to a telephone party line, using a computer and keyboard rather than a telephone. With IRC, however, at any one time there are thousands of different party lines available, in which collectively tens of thousands of users are engaging in conversations on a huge range of subjects In addition, commercial online services such as America Online, CompuServe, the Microsoft Network, and Prodigy have their own “chat” systems

ACLU v. Reno, 929 F. Supp. 824, 835 (E.D. Pa. 1996), *aff’d*, 117 S. Ct. 2329 (1997) (explaining Internet Relay Chat and other types of chat). *See generally* YOUNG, *supra* note 8, at 323-62.

184. *See* Coffee, *supra* note 7, at 1223.

185. *See id.* Typically, when the information posted is revealed as having been inaccurate, the potential liability of the person who posted the message, the issuer to which the message referred, and the Internet service providers become immediate concerns. Generally, ISPs are not liable for messages posted by their customers. *See* Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, § 202, 112 Stat. 2877 (to be codified at 17 U.S.C. § 512).

186. *See id.*

187. *See id.* at 1223-24.

188. *See* Schroeder, *supra* note 23.

America Online's The Motley Fool¹⁸⁹ discussion forum posts message boards that have seen the most notorious instances of market reaction to information posted on the Internet.¹⁹⁰ For example, in 1996, the stock of Diana Corporation was propelled on roller-coaster price swings through postings on the Motley Fool message boards.¹⁹¹ Coined the "darling of the Motley Fool on-line chat room,"¹⁹² Diana Corporation's shares went from under \$10 to nearly \$115 each in one year amid a combination of speculation and unsubstantiated hype.¹⁹³

Then, on May 30, 1996, someone posted a message seeking "anyone willing to 'cooperate with an inquiry into possible violations of federal laws by [Diana Corporation insiders or affiliates] using the Internet for stock manipulation purposes.'"¹⁹⁴ The message said to contact Judy Gilbert of the Stock Exchange Commission's investigative division.¹⁹⁵ Such a commission does not even exist. Regardless, the stock spiraled downward as a result of the posting.¹⁹⁶ By March 6, 1997, the shares were down to 6 and 1/8 in trading.¹⁹⁷ Evidently, Internet users had opinions about Diana Corporation and they were "partly, perhaps largely, responsible for the volatility of its stock price."¹⁹⁸ What remains unclear is who posted the anonymous message. The company's chairman and chief executive officer said neither he nor any of the company's employees had posted any such message on the Internet.¹⁹⁹

189. See *The Motley Fool* (visited Feb. 17, 1999) <<http://www.fool.com/index.htm>>. See E.S. Browning, *Is It Still a Stock Market, or Just a Launch Pad?*, WALL ST. J., June 13, 1996, at C1, for a personal account of an investor who spends 90 minutes a day checking bulletin boards and chat rooms.

190. See Richard Gibson and Drew Ward, *Cyberspace War Rages Over Diana Corp.'s Technology*, WALL ST. J., July 1, 1996, at B4.

191. See *id.* (noting that, in just one week, the stock of Diana Corporation plunged \$17.375, or 30%, when just six weeks earlier it had risen to \$120 per share).

192. Larry Bauman, *Small Stock Focus*, WALL ST. J., Mar. 7, 1997, at C7.

193. See *id.*

194. Gibson & Ward, *supra* note 190.

195. See *id.*

196. See *id.*

197. See Bauman, *supra* note 192.

198. Gibson & Ward, *supra* note 190.

199. See *id.*

Other chat rooms are also quickly gaining notoriety.²⁰⁰ For example, participants on trading-places.net,²⁰¹ a chat room for day traders, routinely engage in touting stocks. The following events, which transpired on March 1, 1999, are illustrative of what is becoming quite commonplace on the Internet.

An onslaught of messages about CNET, a San Francisco company which operates a computer information network on the Web, began in the morning when the stock was trading on NASDAQ in the low 120s.²⁰² For hours, "more than 200 messages, sometimes several a minute, poured forth extolling CNET."²⁰³ The hype snowballed as chat room participants who owned the stock predicted that the stock would soon "fly".²⁰⁴ One message from "skibum" claimed that CNET had been more profitable than Yahoo! during the past quarter.²⁰⁵ This message was followed by others claiming CNET "IS A MONSTER CALL!!!" and an "easy 140."²⁰⁶ By 11:38 a.m., the stock was up more than \$23 per share for the day.²⁰⁷ By the end of the day, trading volume equaled more than twice the number of freely tradable shares and posted a 15 point gain.²⁰⁸ Unbelievably, all of this happened on a day when the company did not announce any news.²⁰⁹ A transcript of the day's trading shows "a remarkable correlation between the movements of CNET's stock and countless brief, often breathless messages posted on the chat room."²¹⁰

200. Other services similar to trading-places.net are Day Traders On-Line, Pristine Trader and the Underground Trader. These services are "live," unlike "the first generation of on-line newsletters which published a plain-vanilla list of stock picks once or twice a day." Susan Pulliam & Rebecca Buckman, *Talking It Up: 'Winner Alert: CNET'; 'Its Gonna Fly Soon'; 'CNET Is a Monster!!!'*, WALL ST. J., Mar. 18, 1999, at A1.

201. See *trading-places.net* (visited Apr. 1, 1999) <<http://www.trading-places.net>>.

202. See Pulliam & Buckman, *supra* note 200, at A1.

203. *Id.*

204. *Id.*

205. See *id.*

206. *Id.*

207. See *id.*

208. See *id.*

209. See *id.*

210. *Id.* CNET is by no means the exclusive beneficiary of the touting that occurs in the trading-places.net chat room. One day in January, 1999, Imagi-nOn, rumored to be in negotiations with America Online, was subject to the

What is most striking about the day's events is the fact that "skibum" is not an anonymous participant but John Jordan, part owner of the trading-places.net chat room.²¹¹ The owners claim that all they do for their subscribers is provide "a spark for a stock that is ready to run."²¹² Jordan naturally maintains that there is no conflict of interest because of his practice of "always 'post[ing] the call' before buying shares."²¹³

Whether this is, or should be, considered market manipulation remains a "perplexing" question.²¹⁴ Of such chat room activity, David Levine of the SEC noted: "The conduct certainly raises an eyebrow and would require some scrutiny."²¹⁵ Furthermore, whether the chat room could be considered an investment adviser required to register with the SEC also seems worthy of consideration.²¹⁶ Clearly, the owners of trading-places.net are in the business of recommending certain stocks; they have hundreds of subscribers who pay \$279.95 a month to be privy to the "trade alerts" and "winner alerts" they post.²¹⁷

The sudden surge in the price and trading volume of Comparator Systems Corporation ("Comparator") in May 1996, serves as a prime example of on-line market manipulation.²¹⁸ This small company, listed for trading on NASDAQ's Small Cap Market, was suddenly rumored to have developed a fingerprint recognition system which could be incorporated into a credit card.²¹⁹ One widely circulated rumor on the Motley Fool chat room suggested that MasterCard would soon adopt the technology.²²⁰ Almost overnight, the stock soared 30-fold from \$.03 per share to over \$1.75 per share, an

chat room's "recommendation." *See id.* Its stock rose from \$9 to \$15 per share, an increase of 66 %. *See id.* When the rumor was denied the following day, the stock plunged back to \$9. *See id.* On April 2, 1999, the stock closed at \$4.

211. *See id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.*

216. *See id.*

217. *Id.*

218. *See Coffee, supra* note 7, at 1224.

219. *See id.*

220. *See id.*

increase in aggregate market capitalization from \$36 million to over \$1 billion.²²¹ On a single day, more than 178 million shares of Comparator stock traded on NASDAQ, breaking the all-time single day volume record for NASDAQ.²²² Ultimately, it was discovered that the technology had been stolen from British researchers and that there was no basis for the MasterCard rumor.²²³ Consequently, the stock price plummeted and Comparator entered bankruptcy that year.²²⁴ Unfortunately, neither the SEC nor the NASD has regulatory authority over ordinary investors who post anonymous messages in chat rooms.²²⁵ Moreover, detecting whether broker-dealers or company insiders are behind the rumors seems to pose a difficult evidentiary task.

Clearly not too difficult, however. The SEC ordered the suspension of trading in Comparator securities from May 14, 1996, to May 28, 1996, because of "questions raised as to the adequacy and accuracy of publicly-disseminated information about Comparator."²²⁶ On May 31, 1996, the SEC filed suit against Comparator and three officers for alleged violations of section 17(a) of the Securities Act and section 10(b) of the Exchange Act and Rule 10b-5.²²⁷ The complaint alleged that the defendants sold tens of millions of shares while materially misrepresenting the financial status of Comparator and its proprietary interest in the fingerprint identification technology.²²⁸ Soon after, in June 1996, the stock was delisted from NASDAQ.²²⁹ On September 16, 1996, the court entered final judgments against Comparator and the individual defendants for violating the anti-fraud, reporting, and books and records provisions of the securities laws.²³⁰ Last year, the judge entered supplemental judgments against

221. *See id.*

222. *See id.*

223. *See id.*

224. *See id.*

225. *See id.*

226. SEC, *Exchange Act Release No. 37,209, May 14, 1996* (visited Feb. 16, 1999) <<http://www.sec.gov/enforce/adminact/3437209.txt>>.

227. *See SEC, Litigation Release No. 14927, May 31, 1996* (visited Feb. 16, 1999) <<http://www.sec.gov/enforce/litigrel/lr14927.txt>>.

228. *See id.*

229. *See Michael Schroeder, Three Ex-Officers of Comparator Get More Penalties*, WALL ST. J., Aug. 21, 1998, at B5.

230. *See SEC, Litigation Release No. 15056, Sept. 19, 1996* (visited Feb. 16,

the three officers, ordering them to disgorge hundreds of thousands of dollars in salary and profits from the sale of Comparator stock.²³¹

The Comparator scandal prompted the NASD to conduct an informal study of other stocks that had experienced similar dramatic increases in stock price and volume.²³² The NASD found "a close correlation between [those increases] and Internet postings."²³³

The most recent and elaborate example of possible market manipulation involved the stock of a technology company traded on NASDAQ, PairGain.²³⁴ On April 7, 1999, the company's stock increased 31 percent after an unknown perpetrator posted a message on Yahoo's financial bulletin board falsely claiming that ECI Telecom would acquire PairGain for \$1.35 billion.²³⁵ Presumably, the goal was to increase the stock price in order to dump shares at a higher price.²³⁶ The manipulator used Angelfire, a Lycos subsidiary which provides free Web space, to create a page which looked virtually identical to a page from the Bloomberg News site,²³⁷ complete with the site's logos, images, and fonts.²³⁸ Then the anonymous message was posted to the bulletin board with a link to the forged site. The stock soared as high as \$11.13 on the false report, and then fell to \$9.38 after the scam was uncovered and executives from both companies vehemently denied any involvement. This occurrence may be the most sophisticated example yet of how ordinary people are defrauding investors through use of the Internet. In other cases, false messages are posted on bulletin boards or in chat rooms and the scam is complete. Here, a false message was posted only to lure investors

1999) <<http://www.sec.gov/enforce/litigrel/lr15056.txt>>.

231. See SEC, *Litigation Release No. 15855, Aug. 20, 1998* (visited Feb. 16, 1999) <<http://www.sec.gov/enforce/litigrel/lr15855.txt>>.

232. See Coffee, *supra* note 7, at 1224.

233. *Id.* (quoting Therese Poletti, *Internet Stock Tips Pose Free Speech Dilemma*, RUETER BUS. REP., June 11, 1996 (quoting Marc Beauchamp of the NASD)).

234. See Gaw, *supra* note 133.

235. See *id.*

236. See *id.*

237. See *Bloomberg News* (visited Apr. 10, 1999) <<http://www.bloomberg.com/welcome.html>>. Bloomberg LP filed a lawsuit as a result of this hoax for trademark infringement, unfair competition, and other civil infractions. See *Bloomberg Files Suit Against 5 "John Does" in PairGain Net Hoax*, WALL ST. J., Apr. 13, 1999, at B5.

238. See Gaw, *supra* note 133.

to the real deceptive device—a “masterful” replica of the Bloomberg site; this incident suggests a whole new opportunity for manipulators—completely copying Web sites.²³⁹

As expected, Lycos would not reveal the identity of the person listed as the creator of the page because of its privacy policy and suggested that the perpetrator had probably used a false name.²⁴⁰ It is the policy of Lycos and Yahoo! to reveal such information only when compelled to do so by court order.²⁴¹ These events spurred disagreement as to whether regulators would be able to locate the perpetrator.²⁴² SEC officials contended that they could find people who use anonymous screen names by using “everything from subpoenas to old-fashioned gumshoe work.”²⁴³ On the other hand, some security experts say a “smart” scam artist would be nearly untouchable if, for example, the person would use a stolen credit card to establish an e-mail account.²⁴⁴ Likewise, a person who uses a computer at a public library, cyber café, or college computer center may easily hide their trail.²⁴⁵

It seems that the perpetrator of this crime was not smart enough. A twenty-five year old North Carolina employee of PairGain was arrested less than a week after he consummated the elaborate fraud; surprisingly, “he left a trail that was remarkably easy to follow.”²⁴⁶ Interestingly, though, authorities did not allege any PairGain trading by the defendant, Gary Hoke, a midlevel development engineer.²⁴⁷ Investigators traced the identity of the Yahoo! message poster to Hoke because he used an e-mail address on Microsoft Corporation’s

239. See Mark Maremont, *Extra! Extra! Internet Hoax, Get the Details*, WALL ST. J., Apr. 8, 1999, at C1.

240. See *id.*

241. See Mark Maremont & William M. Bulkeley, *Who Did the Hoax? SEC Answers A Day After PairGain’s Stock Rockets*, WALL. ST. J., Apr. 9, 1999, at B5.

242. See *id.*

243. *Id.* (quoting John Reed Stark, chief of the Office of Internet Enforcement).

244. See *id.*

245. See *id.*

246. William M. Bulkeley, *Arrest Made In PairGain Internet Hoax*, WALL ST. J., Apr. 16, 1999, at C1.

247. See *id.* at C11.

free HotMail service; that same address was used to set up an account on the Angelfire service where the fictitious page was posted.²⁴⁸

What is most notable about the PairGain hoax is that, unlike other manipulations of the recent past, PairGain is not a micro cap. The investing public holds 52.8 million shares and nearly two million shares trade hands daily.²⁴⁹ Nevertheless, its stock seems just as easy to manipulate.

This criticism is not to imply that bulletin boards have no value. On the contrary, especially for small investors who have limited economic and informational resources, bulletin boards offer access to valuable information previously reserved for investors who could afford a patient and attentive broker. Investors who make decisions based on information they gather on the Internet must beware of the potential for disaster.

3. Spamming

Spam, or unsolicited commercial e-mail, is a cost-effective and easy way to communicate with a large number of Internet users.²⁵⁰ A user receives spam from a sender who has obtained the user's e-mail address from a mailing list, newsgroup, or directly from the user on a Web site.²⁵¹ A user's e-mail address may also be on a list commercially available to spammers.²⁵² As a result, manipulators can use spam to reach prospective investors for shady investment schemes or to spread false information about a company. Spam allows the unscrupulous to target many more potential investors than through cold calling or mass mailing. Using readily available spam programs, the aspiring manipulator can send personalized messages to thousands, even millions, of Internet users.²⁵³ The practice has

248. *See id.*

249. *See id.*

250. *See* YOUNG, *supra* note 8, at 173-75.

251. *See id.* at 173.

252. *See id.*

253. Spam has become a major problem on the Internet. To counter the large volume of spam promising get-rich-quick schemes, one site offers a possible solution—Spam Hater. It is free, Windows-based software that is available on-line. It automatically responds to spam with an e-mail message to the sender. *See Hit Back at the Spammers!* (visited Feb. 17, 1999)

become so bothersome that California has passed a law prohibiting any person or entity conducting business in the state from e-mailing unsolicited advertising materials without providing a return e-mail address.²⁵⁴ Despite such laws, users are still bombarded with spam offering get-rich-quick schemes.

In October 1998, the SEC filed a complaint against an Internet stock touting service, Stockstowatch.com, Inc. ("STW"), and its president, Steven King, for alleged violations of the antitouting and antifraud provisions of the Act by touting and scalping shares of five publicly traded micro cap companies.²⁵⁵ In exchange for shares of the companies, the service touted the stocks in e-mail sent to STW's 200,000 subscribers.²⁵⁶ For example, STW sent spam promoting Surgical Safety Products claiming that "[the stock] will be a \$20 stock within 18 months."²⁵⁷ The stock price surged from 96 cents to \$3.13 upon dissemination of the recommendation, a 200% increase.²⁵⁸ The defendants sold their shares while recommending that investors buy shares; in essence, they scalped their securities and reaped a \$573,753 profit.²⁵⁹

Having succeeded, the defendants committed the same crime again on May 23, 1998; this time STW profiled Midland, Inc.²⁶⁰ In its e-mails, STW stated that Midland "can become a \$75 stock" because of "its ability to generate long term growth."²⁶¹ The stock price increased the next day from \$1.03 to \$2.63 before closing at \$1.44; trading volume had increased over 100 percent.²⁶² Again, the defendants scalped shares they received from the company and for a gain of \$172,000.²⁶³ The scalping is alleged to have violated

<http://www.cix.co.uk/~net-services/spam/spam_hater.htm>. Another program, Spamicide, moves spam to a trash folder and allows the user access only to the user's "real" e-mail. See *Spamicide* (visited Feb. 17, 1999) <<http://www.cix.co.uk/~net-services/spam>>.

254. See CAL. BUS. & PROF. CODE § 17538.4 (West 1997 & Supp. 1999).

255. See SEC, *Litigation Release No. 15956*, Oct. 27, 1998 (visited Mar. 4, 1999) <<http://www.sec.gov/enforce/litigrel/lr15956.txt>>.

256. See *id.*

257. *Id.*

258. See *id.*

259. See *id.*

260. See *id.*

261. *Id.*

262. See *id.*

263. See *id.*

sections 17(a) and 10(b) of the Exchange Act; moreover, the failure to disclose to prospective investors that the defendants received shares as compensation violated section 17(b) of the Act.²⁶⁴ All in all, STW and King derived a profit of more than one million dollars from scalping micro cap shares. The inapplicability of section 9 renders the general antifraud provisions the only applicable law to the situation.

The most notorious massive spam campaign to promote stocks involved Francis Tribble and his public relations firm, Sloane Fitzgerald.²⁶⁵ The complaint alleged that Tribble and Sloane Fitzgerald touted two micro cap stocks, Eventemp Corporation and JT Restaurants, Inc., without disclosing the fact, nature, and amount of consideration received in violation of section 17(b) of the Act.²⁶⁶ During the period between November 1997, and August 1998, Tribble disseminated more than six million e-mail spams to tout the potential earning power of the micro cap stocks.²⁶⁷ Many of the e-mails "purported to be from independent stock promoters such as 'HotStock,' 'Net-Vest,' and 'Cyber-Stock,' which were actually only names Tribble invented."²⁶⁸ Moreover, spams referred recipients to other sites Tribble had created to recommend the stocks. Then in August 1998, Tribble wrote an on-line newsletter touting JT Restaurants and sent it to 200 subscribers whom he had solicited through previous spams and site visits.²⁶⁹ Having received stock and cash for his touting efforts, Tribble had a vested interest in an increase in the stock price.

The SEC filed a civil action against Tribble and his company for violating section 17(b) of the Act; the defendants consented to be enjoined from any further violations of the section and agreed to pay a \$15,000 penalty.²⁷⁰ It is arguable whether this punishment is adequate for a man whose spam campaign was the subject of the largest

264. *See id.*

265. *See SEC, Litigation Release No. 15959, Oct. 27, 1998* (visited Mar. 4, 1999) <<http://www.sec.gov/enforce/litigrel/lr15959.txt>>.

266. *See id.*

267. *See id.*

268. *Id.*

269. *See id.*

270. *See id.*

number of complaints ever received in the history, albeit a short one, of the agency's Enforcement Complaint Center.²⁷¹

C. *The SEC's Response to On-line Securities Violations*

The purpose of the SEC is to regulate the securities markets to ensure, "to the extent practicable, that the markets are fair, open efficient, transparent, orderly and competitive."²⁷² The agency accomplishes this goal through regulation and supervision of broker-dealers, the exchanges, clearing agencies, transfer agents, and securities information processors.²⁷³ Prior to the advent of the Internet, the SEC's enforcement division had never experienced such a "rapid and extreme transformation" of its rules of engagement.²⁷⁴ Consequently, the application of existent federal securities law to the Internet remains relatively undeveloped.²⁷⁵

"Since 1995, the SEC has initiated [sixty-six] enforcement actions against alleged perpetrators of Internet securities fraud."²⁷⁶ By February 1999, thirty-two of the sixty-six cases had largely been concluded; defendants generally were required to either pay civil penalties and/or refrain from further securities law violations.²⁷⁷ Despite the seemingly light punishment for on-line market manipulation or fraud, in two of the thirty-two cases, state or federal prosecutors obtained criminal convictions or prison sentences for seven individual defendants.²⁷⁸

271. *See id.*

272. *SEC Report, supra* note 45.

273. *See id.*

274. Stark, *supra* note 136, at 10.

275. This paper addresses the antimanipulation and antifraud provisions of the federal securities laws; however, state securities laws, commonly known as "blue sky laws," and state criminal laws may also cover securities fraud on the Internet. For example, a California man was recently convicted on 53 state criminal counts and was handed a harsh, ten year sentence after being charged with grand theft, the sale of unregistered securities and fraud in connection with an Internet stock offering. *See* Rebecca Buckman, *California Man Gets 10 Years in Jail For Securities Fraud on Internet*, WALL ST. J., Nov. 6, 1998, at B2. Nearly half of all state regulatory agencies have established specific programs to combat Internet frauds that violate state securities laws. *See GAO Testimony, supra* note 21, at 13.

276. *GAO Testimony, supra* note 21, at 13.

277. *See id.*

278. *See id.*

Moreover, computer technology shows no indication of slowing down; indeed, the United States has recently committed to support a world-wide expansion of the Internet.²⁷⁹ As a result, use of on-line communications to perpetrate market manipulations will remain a constant and increasingly pressing concern.

Despite the societal and economic changes the Internet has effected thus far, the SEC has sought no new statutes, regulations, or rules to protect investors from becoming victims of crime committed over the Internet.²⁸⁰ The SEC has no intention to seek new enforcement statutes, regulations, or remedies to detect and prosecute securities fraud on the Internet.²⁸¹ "The same case law . . . applies whether the activity is done by carrier pigeon or the Internet."²⁸² Moreover, the agency maintains that congressional intervention is unnecessary and that the present antifraud weapons will more than suffice.²⁸³ The agency maintains that current laws are sufficiently flexible to apply to securities violations perpetrated over the Internet; only the application of the laws must evolve.²⁸⁴

In 1997, the SEC was adamant that the agency did not need anything more than it already had in its arsenal to combat market manipulation.²⁸⁵ More recently however, in the summer of 1998, the SEC established the Office of Internet Enforcement ("OIE") specifically to address the high number of securities violations perpetrated on the Internet.²⁸⁶ The specialized unit, headed by John Reed Stark, was formed in response to the more than thirty cases already brought

279. See Jeanne Cummings, *Gore to Outline Guide to Growth for the Internet*, WALL ST. J., Oct. 12, 1998, at A4.

280. See Cella & Stark, *supra* note 29, at 835.

281. See *id.* at 817.

282. Karen Alexander, *Anti-Fraud Sweep Highlights Online Oversight, But Can Agency Police Cyberspace's Vast Reaches?*, LEGAL TIMES, Nov. 2, 1998, at 15 (quoting SEC Commissioner Paul Carey).

283. See *id.*

284. See *id.*

285. The SEC's Division of Enforcement commonly investigates market fluctuations in particular stocks which "do not appear to result from general market trends or from known developments affecting the issuing company." SEC Division of Enforcement Complaint Center (visited Feb. 13, 1999) <<http://www.sec.gov/enforce/comctr.htm>>.

286. See SEC NEWS DIGEST, Issue 98-144, July 28, 1998.

by the summer of 1998 involving securities fraud on the Internet.²⁸⁷ Cases thus far have involved "virtually every type of investment scam, including phony offerings, market manipulations, affinity frauds (e.g., frauds that target a particular ethnic or religious group), and pyramid and ponzi schemes."²⁸⁸

The OIE coordinates the SEC's response to the increasing reports of on-line securities fraud.²⁸⁹ OIE is primarily responsible for developing policies and procedures for Internet surveillance, managing e-mail complaints, and providing guidance for conducting Internet fraud investigations.²⁹⁰ Only three full-time staff members work for OIE but it has over 125 on its volunteer staff roster in SEC offices nationwide who spend a couple of hours weekly identifying potential securities violations on the Internet.²⁹¹

In the summer of 1998, the SEC's on-line Enforcement Complaint Center received an average of more than 120 complaints every day regarding potential securities violations.²⁹² By March 1999, the number of daily fraud tips had risen to 300.²⁹³ Because there are no comprehensive statistics available on the actual incidence of securities violations committed over the Internet, the increase in the number of complaints received by the SEC is the only reliable indicator of the possible severity of the emerging problem. Note, however, that the complaints indicate only the number of investors who suspect that they have been defrauded.

The SEC employs the following multi-faceted approach to battle securities violations on the Internet. First, the SEC has increased surveillance by assigning staff members to monitor the Internet.²⁹⁴ Second, the SEC promises to aggressively investigate and prosecute securities fraud on the Internet.²⁹⁵ Third, the SEC embraces self-policing by encouraging users to report dubious offerings or

287. *See id.*

288. *Id.*

289. *See GAO Testimony*, *supra* note 21, at 9.

290. *See id.*

291. *See id.*

292. *See id.*

293. *See Schroeder*, *supra* note 23.

294. *See Cella & Stark*, *supra* note 29, at 836.

295. *See id.* at 837-44.

suspicious postings to the on-line Enforcement Complaint Center,²⁹⁶ which began operation in June 1996.²⁹⁷ Fourth, the SEC views education as a critical aspect of the program²⁹⁸ and frequently publishes literature to help Internet investors ensure against becoming the next victim of fraud.²⁹⁹

Finally, the SEC engages in both formal and informal liaison work with the Federal Trade Commission, the U.S. Department of Justice, the Federal Bureau of Investigation, and the Federal Communications Commission.³⁰⁰ In December 1996, the SEC joined forces with three other federal agencies and local law enforcement from twenty-four states for "Surf Day," which resulted in identifying more than 500 possible Internet scams.³⁰¹ Furthermore, the SEC works closely with the NYSE, the NASD, and other self-regulatory organizations in order to combat securities law violations on the Internet.³⁰² In November 1998, "Investment Opportunity Surf Day" resulted in finding dozens of potential consumer financial frauds among over 400 sites. Incidentally, regulators send warning messages to the sites and normally do not take enforcement action on the basis of surf day findings.³⁰³

Combating securities law violations on the Internet does not comport with traditional concepts of the federal securities laws.³⁰⁴ Nevertheless, the SEC is commendably prosecuting most Internet manipulation and fraud cases using section 10(b). In most cases discussed above, the defendant was the company and/or its corporate insiders or affiliates. Clearly, problems will arise where the alleged manipulator remains anonymous and beyond the law's reach. Unfortunately, neither the SEC nor the NASD have regulatory authority

296. See *SEC Division of Enforcement Complaint Center* (visited Feb. 13, 1999) <<http://www.sec.gov/enforce/comctr.htm>>.

297. See *GAO Testimony*, *supra* note 21, at 6.

298. See Cella & Stark, *supra* note 29, at 845-46.

299. See *Investor Assistance and Complaints* (visited Feb. 13, 1999) <<http://www.sec.gov/invkhome.htm>>.

300. See Cella & Stark, *supra* note 29, at 846.

301. See *id.*

302. See *id.* at 846-47.

303. See *id.*

304. For example, the Securities Act of 1933 makes a basic distinction between "written" and "oral" communications. See 15 U.S.C. § 77b(10) (1994). Internet postings do not seem to fit in either category.

over ordinary investors who post anonymous statements in chat rooms, and neither agency can easily detect if broker-dealers are behind the rumors posted.

One problem presented is that the First Amendment may protect the right to engage in anonymous speech.³⁰⁵ Where commercial speech is at issue, as in the case of market manipulation, a far more permissive standard would apply than that which would be applied to political speech.³⁰⁶ That is, commercial speech receives only limited First Amendment protection. However, anonymity is an alluring characteristic of the Internet and suppressing it would be unwelcome. Nevertheless, securities regulators need the ability to trace identities of authors who have sent anonymous e-mails or posted information in chat rooms on an after-the-fact basis.³⁰⁷

A major obstacle to this effort is the rise of anonymous "remailers," which conceal the user's identity and location.³⁰⁸ Typically, a cooperating agent who remails the statement to the chat rooms is needed to conceal the sender's identity. Potentially, such an agent could be considered an aider and abetter of a securities law violation.³⁰⁹ The problem with this approach is that the aider may not have the requisite intent if he or she did not know that the statement was false or fraudulent. It should be noted, however, that new section 20(f) of the Exchange Act requires only that the defendant knowingly provide substantial assistance to another person.³¹⁰

Clearly, because of the difficulty in tracing Internet communications, the Internet creates unique challenges to regulators attempting to collect evidence. As is evident from the Internet cases discussed previously, there is "a particular danger in deception on Internet message boards and chat rooms, where anonymity can be a particularly vexing problem."³¹¹ Interestingly, only one of the

305. See, e.g., *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334 (1995); *Talley v. California*, 362 U.S. 60 (1960) (holding a city ordinance prohibiting the distribution of anonymous handbills unconstitutional).

306. See *McIntyre*, 514 U.S. at 343-44, 348-51.

307. See Coffee, *supra* note 7, at 1225.

308. See A. Michael Froomkin, *Anonymity and Its Enmities*, 1995 J. ONLINE L. art. 4, ¶ 20-25.

309. See 15 U.S.C. § 78t (1994).

310. See *id.* § 78t(f) (1994).

311. Jason Anders & Carrie Lee, *SEC Actions Underscore the Dangers But*

forty-four SEC actions brought in the Internet cases "dealt exclusively with the use of message boards to promote stocks."³¹²

This matter is further complicated by the fact that the Internet crosses jurisdictional lines and the laws and regulations relating to data preservation vary by country. Assuming senders and recipients can be identified, the challenge for regulators may be as fundamental as not knowing whether to obtain the relevant evidence from the access provider, the subscriber service, or the parties to the communication itself.³¹³ Moreover, the extent to which regulators can compel data from those who maintain it, such as third party subscriber services, may not be settled in many jurisdictions.

The method of information dissemination may also be a critical factor in prosecuting manipulators. Those who publish articles or periodicals on the Internet are more likely to be caught because victims may have printed out the information. On the other hand, perpetrators who tout stock in a chat room or through e-mail benefit from both the lack of regulation in those domains and the lack of paper trails.³¹⁴ The absence of archives on the Internet also presents an evidentiary nightmare.

According to a new study commissioned by the Senate investigations panel, "rapid growth in online securities scams 'could ultimately place a significant burden on the regulators' investigative-staff resources and limit the agencies' capacity to respond effectively."³¹⁵ The study predicts that regulators do not have adequate human and technological resources to coordinate policing activities.³¹⁶

Won't Safeguard Online Investors, WALL ST. J., Nov. 2, 1998, at A25E (quoting John Coffee, a Columbia University Law School professor).

312. *Id.*

313. See International Organization of Securities Commissions, *supra* note 132, at 229.

314. See Will Morrow, *Is the Internet Participating in Securities Fraud?: Harsh Realities in the Public Domain*, 72 TUL. L. REV. 2203, 2209 (1998).

315. Schroeder, *supra* note 23.

316. See *id.*

V. PROPOSALS FOR EFFECTIVELY COMBATING ON-LINE MARKET MANIPULATION

One possible resolution to the increasing securities violations being perpetrated over the Internet would be to prosecute the operator of the chat room. Those who sponsor and monitor chat rooms and newsgroups focused on securities valuation topics ought to be "gatekeepers" charged with and subject to obligations to combat Internet fraud.³¹⁷ Such a recommendation would require enactment of new legislation. While theoretically sound, this suggestion may be unrealistic. Nevertheless, the result of such a suggestion would "throw sand in the gears that connect global markets."³¹⁸

Most chat rooms have private sponsors who limit access to subscribers. Some pressure could be levied on the on-line service providers to delete comments that come from anonymous remailers. Providers already monitor chat rooms to delete obscenity; an additional monitoring requirement may not be too burdensome. However, providers are not legally obligated to do so.³¹⁹

The SEC clearly has authority over the broker-dealer industry. Undoubtedly, broker-dealers must disclose their own identities, but the question here revolves around vicarious liability for the communications of others.³²⁰ The NASD prohibits broker-dealers from linking to Web sites that the member knows to contain misleading information about the member's products or services. Arguably, this rule could be extended to preclude linking to sites on which anonymous and non-traceable communications are prevalent.

It seems apparent that finding an entity that can be easily persuaded or pressured into taking on the responsibility of monitoring the content or traceability of postings on the Internet will be difficult. For example, the Silicon Investor has said that it "can't possibly police the thousands of messages that whiz by on its system each

317. See Coffee, *supra* note 7, at 1232.

318. *Id.*

319. Pursuant to the Communications Decency Act of 1996, providers are not treated as the publishers or speakers of information provided by another person. See 47 U.S.C. § 230(c)(1) (1994).

320. See Charles Schwab & Co., Inc., SEC No-Action Letter, [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,353, at ¶ 77,768 (Nov. 27, 1996).

day.”³²¹ Instead, Silicon Investor relies on the SEC to protect investors. Until there is such a gatekeeper, the anarchic culture of the Internet will insist that it remain beyond the reach of the law’s arm.

Recently, the *Wall Street Journal* quoted a statement made by SEC Enforcement Chief Walker: “[t]he Internet isn’t impossible to police.”³²² Indeed, proverbial wisdom tells us that nothing is impossible. However, the emergence of the Internet has also introduced new justifications for both new enforcement measures and/or some form of legislative enactment which would provide a realistic and workable scheme to combat on-line market manipulation.

As the Internet continues to grow, Congress must grant additional authority to regulators so that the agencies may promulgate rules specifically prohibiting market manipulation effected through the use of the Internet. The legislature must balance the benefits of the Internet with the need to protect innocent investors and the market from manipulation. Revamping the current statutory framework would behoove the SEC in its attempt to target on-line market manipulation, especially of smaller companies’ stock. Allowing manipulators to distort market prices without a credible threat of prosecution disparages the public policies upon which our federal securities laws are based.

In addition to legislative measures, better investor education is necessary. With every day that passes, concerns about the increasing potential for market manipulation are mounting. “Never, ever make an investment based solely on what you read in an online newsletter of Internet bulletin board, especially if the investment involves a small, thinly-traded company that isn’t well known,” said Nancy M. Smith, Director of the SEC’s Office of Investor Education and Assistance.³²³ “Assume that the information about these companies is not trustworthy unless you can prove otherwise through your own independent research.”³²⁴

321. Anders & Lee, *supra* note 311, at A25E.

322. Schroeder & Buckman, *supra* note 147, at C1.

323. *SEC Charges 44 Stock Promoters in First Internet Securities Fraud Sweep* (visited Mar. 4, 1999) <<http://www.sec.gov/news/netfraud.htm>>.

324. *Id.*

VI. CONCLUSION

Securities trading is nothing new. In the 1100s, ownership shares in French textile mills were traded;³²⁵ in 1531, the first stock exchange was established in Antwerp, Belgium.³²⁶ The NYSE, now the world's largest exchange in trading volume, was founded in 1792.³²⁷ As trading methods and resources developed, exchanges began disseminating price data on a broader range of companies to a wider range of people.³²⁸ Suddenly, the importance of timely and accurate information became apparent. Consequently, "access to information led, inevitably, to efforts to manipulate markets."³²⁹ In 1719, satirist and avid investor Jonathan Swift criticized traders for "'coining false news'" and "'whispering imaginary terrors, frights, hopes [and] expectations.'"³³⁰

In 1999, mouse clicks have succeeded whispers. Modern investors have changed the face of the securities markets by using the Internet to seek and discuss investment opportunities. Technological advances have allowed participation in the securities markets to become more affordable, time efficient, and accessible to a growing audience of prospective investors. Although theory dictates the benefits of greater informational access, practice suggests that technology facilitates market manipulation by providing a new medium for disseminating false or inaccurate information.

In time, the federal securities laws must evolve to incorporate prohibitions against specific crimes perpetrated on the Internet. Otherwise, market integrity will fall victim to the disturbing trend toward on-line market manipulation. In a new world where the securities markets are increasingly moved by ordinary people clicking a mouse, the law must adapt to address the burgeoning use of technology to commit market manipulation. Simply attempting to apply old law to new and sophisticated crimes will not suffice for long, despite regulatory officials' adamant statements to the contrary.

325. See McGee, *supra* note 3, at S11.

326. See *id.*

327. See *id.*

328. See *id.*

329. *Id.*

330. *Id.*

The SEC is using every possible tool to repair the problems created by on-line market manipulation as they arise. Perhaps the agency's commendable responsiveness is adequate at present. Ultimately though, the SEC will realize that its tool kit does not contain satisfactory instruments capable of preventing, surveying, discovering, or repairing substantial damage caused by an inevitable increase in on-line fraud and market manipulation. It would be naïve to believe the SEC could somehow outrun these new-world bandits who "get away" through the use of Internet technology; however, keeping pace with on-line market manipulation must become an attainable goal in order to protect the integrity of the securities markets.

*Nancy Toross**

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